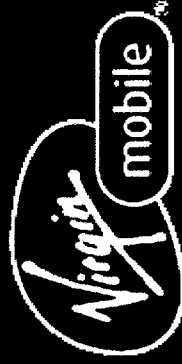


Universal Service
Reform and State
Regulation of Wireless
Services



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**Federal Communications Commission
March 17, 2005**

I. Introduction to Virgin Mobile USA (VMU)

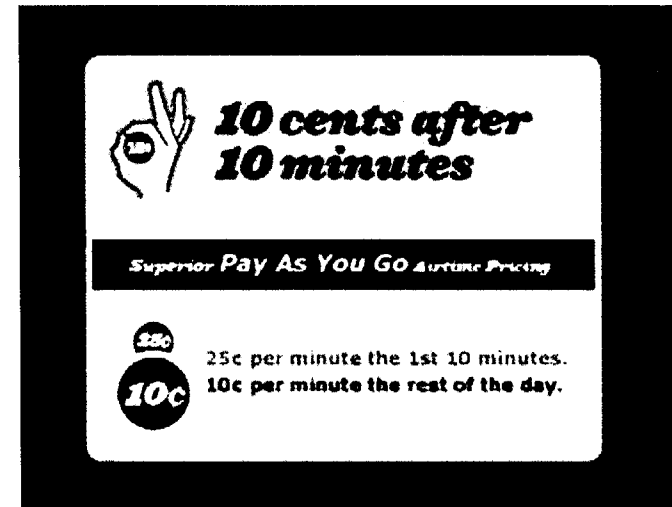
- First Mobile Virtual Network Operator (MVNO) in the U.S.
 - Joint venture between Sprint and Sir Richard Branson's Virgin Group.
 - 3 million customers in just 2.5 years of operations.
 - Operates on Sprint's nationwide CDMA network.
 - Pay as you go: No long-term contracts.
 - Handsets available at 20,000 stores; Top-up cards available at 57,000 locations.
 - Focus on low-cost, affordable service to the following customers:
 - Low-income: A significant % of VMU customers have incomes below \$35k.
 - Without prior wireless service: Many VMU customers are new to mobile services.
 - Diverse: A disproportionate amount of VMU customers are non-white (African-American, Latino, etc.).
 - Youth market: A majority of VMU's customers are 34 or younger.
- Virgin Mobile develops and maintains the entire customer experience.
 - Billing, customer care, handset graphic interface, and website.
 - Content and applications (VirginXtras and VirginXL): ringtones, games, comedy, entertainment information.



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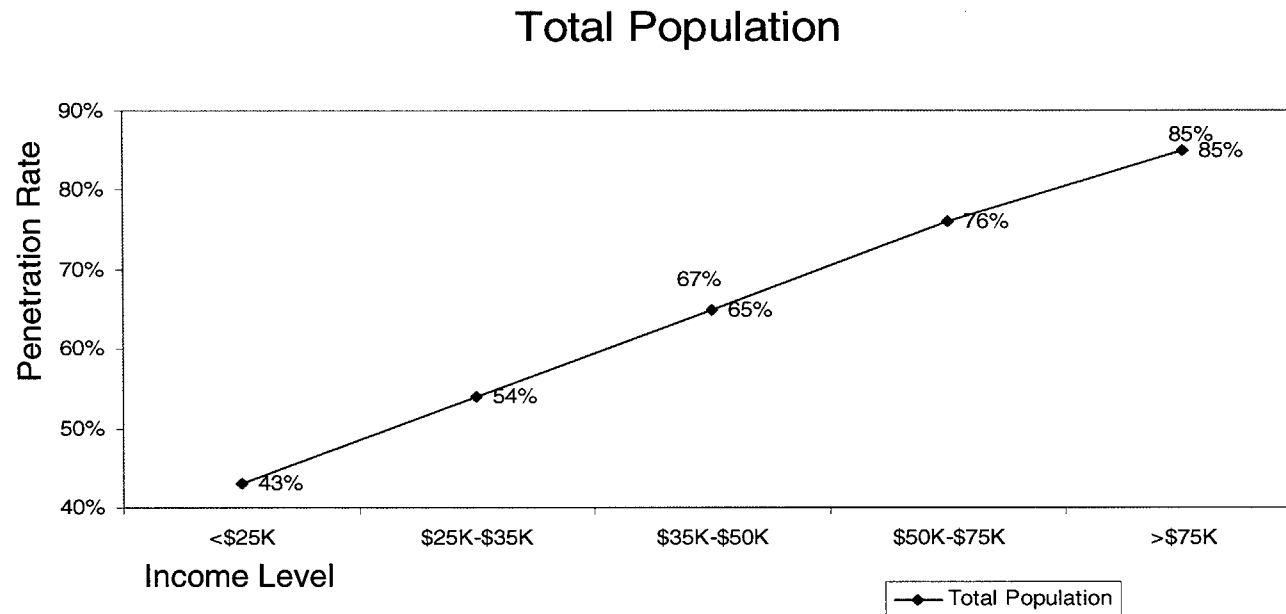
I. Introduction to VMU (cont'd)

- Service Features/Value Proposition
 - Pay as you go (prepaid) service.
 - Customers only charged for minutes they want
 - No long-term contracts or monthly bills.
 - No credit checks
 - "Grab and go" product
 - All inclusive pricing (25-10-10).
 - No extra charges for regulatory fees, taxes, voicemail, or long distance.
 - **Postpaid carriers pass through all fees and benefit by having increased revenue growth rates.**
 - Flexible payment.
 - Prepaid cards purchased
 - Handset
 - Internet
 - Instant Top-Up
 - Innovative pricing benefits lower-usage, less-affluent customers.



II. Facts About the Prepaid Market

- Most wireless operators focus on high-income subscribers because subscription to wireless services is highly-dependent on income level:



- Many prepaid customers are lower-usage, lower-income consumers.
- Lower-income consumers receive advantages from prepaid service: Access to mobile services; Value for their money, and Access to emergency services on wireless devices.
- Prepaid services have expanded the availability of wireless services to customers not otherwise able to access wireless service.

III. Universal Service Fund (USF) Overview

- Virgin Mobile supports USF reform to decrease USF contribution obligations from all carriers while preserving the viability of the USF.
 - Expand USF contribution base.
 - Limit growth of High-Cost support mechanisms.
 - Eliminate USF waste and fraud.
- Connection-based solutions discriminate against providers of prepaid wireless services.
 - Connection-based USF reform proposals would constitute a regressive regime disproportionately harming lower-income, prepaid customers.
 - If the FCC does adopt a connection-based approach, it should provide alternatives for prepaid wireless providers:
 - Charge \$0.75 connection fee only to “Active Prepaid Handsets” - those generating more than \$30 voice ARPU.
 - USF fee waived for prepaid handsets with revenue less than \$30.



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III. USF Overview (cont'd)

- Contribution Base

- The current pool of contributors cannot satisfy the increasing demands placed on the USF. Large classes of carriers are exempt from USF contribution obligations.
 - Eliminate exemption for VOIP (Wireline and Cable) services.
 - As VOIP usage grows, USF contribution base decreases accordingly, requiring increased contributions from existing contributors to cover shortfall.
 - VOIP revenue will increase while traditional telecommunications providers face a concomitant decline.

- High-Cost Support

- The dramatic increase in High-Cost support payments (up 44% since 2000) is primarily responsible for the overall increase in USF contribution obligations.
- Limiting the growth of High-Cost support payments is necessary to reduce overall USF contribution obligations.

III. USF Overview (cont'd)

- High-Cost Support (cont'd)

- Level playing field for all carriers by adopting “forward-looking” cost methodologies. (Smaller carriers currently permitted to recover higher, “historic” costs).
- Restrict Eligible Telecommunications Carriers (ETCs) to one per market.

- Waste and Fraud

- The FCC must limit the waste associated with the USF.
 - Cap on High-Cost USF payments to individual carriers.
- The FCC Inspector General’s Sept. 30, 2004 report to Congress indicated that 36% of the total USF/E-Rate disbursements that the IG’s office had investigated were non-compliant with USF requirements.
 - Increase the resources dedicated to detecting and punishing USF fraud.

IV. Effect of USF Obligations on Lower-Income, Lower-Usage Customers

- Unlike local telecommunications services, demand for wireless services, especially prepaid services, is highly elastic: as prices go up, demand falls.
- Lower-income, prepaid customers are particularly sensitive to the adverse impact of higher USF contribution obligations.
 - Increased USF contribution rates might cause lower-income, prepaid customers to drop their wireless phone service altogether. (Many VMU customers are new to wireless.)
- Regulatory policies should spur increased wireless usage rates among lower-income consumers to drive overall wireless penetration higher.

V. Effect of USF Obligations on Virgin Mobile

- A shrinking contribution base, the explosive growth in High-Cost demand, and waste and fraud have caused USF contribution rates to increase dramatically.
 - Increasing USF contribution obligations threaten innovative business models, especially prepaid wireless services.
 - Virgin Mobile does not pass-through regulatory fees and taxes to customers. As a result, Virgin Mobile must build regulatory fees and taxes into its cost structure.
 - In contrast, postpaid wireless carriers pass through USF fees.
 - The burden of increased USF contributions on postpaid carriers, therefore, is partially offset by the corresponding increase in revenue.
- USF obligations impair the range of pay as you go wireless service for the lower-income customers it was designed, in part, to benefit.



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VI. Connection-Based Solutions Adversely Affect Prepaid Providers

- Lower-income, prepaid customers would pay a disproportionate USF amount if \$1/month/connection fee.
 - Hypothetical postpaid subscriber with \$58 ARPU.
 - \$1 fee = 1.7% of monthly bill.
 - Hypothetical prepaid customer with \$28 ARPU.
 - \$1 fee = 3.6% of monthly bill.
 - Connection-based proposals would require lower-income, prepaid customers to pay into the USF - even if they had no interstate usage in a given month.
- Prepaid providers would have to pass through costs and fees to customers.
- A connection-based approach would be a regressive tax that would place a disproportionate burden on lower-income, prepaid customers, forcing them to subsidize higher-income, higher-volume users.

VII. Alternative Connection-Based Solutions

- If the Commission does adopt a connection-based solution, it should take into account the discriminatory effect that a connection-based approach would have on providers of prepaid wireless services.
- Options to reduce the discriminatory burden on prepaid providers:
 - Impose \$0.75 connection fee only on “Active Prepaid Handsets”:
 - Generate at least \$30 carrier voice revenue in a month.
- The FCC waives other regulatory fees for low-income customers:
 - Subscriber line charge.



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VIII. Conclusions

- Fundamental reform is vital to achieving the pro-consumer and pro-competitive goals of the USF system.
- The USF “crisis” arises from the failure to adequately assess USF contributions on all carriers, the increased demand for High-Cost support, and waste and fraud in the USF program.
- Reform should focus on the following actions:
 - Expand the base of contributors to increase USF revenue (problem only increases as VOIP usage grows):
 - Include VOIP (wireline and cable) providers.
 - Adopt policies that decrease demand on High-Cost support fund:
 - Level playing field by adopting forward-looking cost methodologies for all carriers.
 - Restrict competitive ETCs to one per market
 - Limit waste and fraud in the USF:
 - Cap on High-Cost payments.
 - Increase resources for fraud detection.
- Any connection-based solution should take into account the discriminatory effect on providers of prepaid wireless services:
 - Impose \$0.75 connection fee only on Active Prepaid Handsets.
 - USF fee waived for prepaid handsets with less than \$30 in revenue.

VIII. State Regulation of Wireless Services

- The Rise of State Regulation
 - Most state regulations, taxes, and fees directly conflict with Section 332's prohibitions on regulating the rates/entry of wireless providers.
 - According to CTIA, state governments introduced 1,541 pieces of legislation in 2003 to regulate the wireless industry:
 - State "consumer protection" requirements.
 - E911 fees.
 - Taxes - 19 states tax wireless services at double-digit rates.
 - State regulatory fees and taxes have the direct effect of raising wireless providers' rates, especially the rates of prepaid providers who cannot recover these costs from customers.
 - Lower-income customers bear a disproportionate burden of per-line, rather than usage-based state fees and taxes.
 - The trend toward increasing the amount and applicability of these "consumer protection" requirements, fees, and taxes (especially to prepaid wireless operators) threatens Congress' intentions for a deregulated wireless marketplace and greatly affects prepaid carriers' ability to offer services to lower-income customers.



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IX. Preemption of State Regulation

- Federal Preemption is necessary to protect the wireless market from burdensome state regulation.
 - Federal preemption has been effective in eliminating state regulation and spurring the widespread deployment of other services (VOIP, broadband).
 - The FCC correctly preempted state regulation of VOIP and broadband services and should apply its preemption principles consistently for all telecommunications and information services providers - resulting in numerous benefits for the wireless marketplace:
 - Lower prices for all customers (including lower-income).
 - Continued expansion of wireless service to a broader range of customers.



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